

AMENDED IN SENATE JANUARY 21, 2004

SENATE BILL

No. 516

Introduced by Senator Speier

February 20, 2003

An act to ~~add Section 23820 to~~ *amend Section 23802 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.*

LEGISLATIVE COUNSEL'S DIGEST

SB 516, as amended, Speier. Subchapter ~~"S corporations"~~ *"S" corporations.*

~~The Corporation Tax Law allows certain small corporations to elect to be treated as "S corporations" whereby those corporations obtain the tax advantages of partnerships, including reduced taxation at the entity level, while retaining the corporate characteristic of limited liability.~~

~~This bill would limit the use of "S corporation" status to only those corporations with less than \$20,000,000 in total gross receipts for the taxable year.~~

Existing law provides that a corporation that is an "S" corporation pursuant to a specified federal statute is treated as an "S" corporation for purposes of the Corporation Tax Law. The Corporation Tax Law imposes taxes measured by income, and in the case of an "S" corporation imposes a tax at a rate of 1½%.

This bill would, for taxable years beginning on or after January 1, 2004, increase the existing tax rate of 1½% to 2% or 2.5%, as applicable, for "S" corporations with taxable income over certain specified amounts.

This bill would result in a change in state taxes for the purpose of increasing state revenues within the meaning of Section 3 of Article

XIII A of the California Constitution, and thus would require for passage of the approval of $\frac{2}{3}$ of the membership of each house of the Legislature.

This bill would take effect immediately as a tax levy.

Vote: $\frac{2}{3}$. Appropriation: no. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 ~~SECTION 1. Section 23820 is added to the Revenue and~~
2 *SECTION 1. Section 23802 of the Revenue and Taxation Code*
3 *is amended to read:*
4 23802. (a) Section 1363(a) of the Internal Revenue Code,
5 relating to the taxability of an ~~“S corporation,”~~ “S” corporation,
6 does not apply.
7 (b) Corporations that are ~~“S corporations”~~ “S” corporations
8 under this chapter shall continue to be subject to the taxes imposed
9 under Chapter 2 (commencing with Section 23101) and Chapter
10 3 (commencing with Section 23501), except as follows:
11 (1) ~~The~~ (A) *For taxable years beginning before January 1,*
12 *2004, the tax imposed under Section 23151 or 23501 shall be*
13 *imposed at a rate of 1½ percent rather than the rate specified in*
14 *those sections.*
15 (B) *For taxable years beginning on or after January 1, 2004,*
16 *the tax imposed under Section 23151 or 23501 shall be imposed*
17 *at the following rates rather than the rate specified in those*
18 *sections:*
19 (i) *For that portion of taxable income that is one hundred*
20 *thousand dollars (\$100,000) or less, the tax rate is 1.5 percent.*
21 (ii) *For that portion of taxable income that is over one hundred*
22 *thousand dollars (\$100,000) but not over one million dollars*
23 *(\$1,000,000), the tax rate is 2 percent of the excess over one*
24 *hundred thousand dollars (\$100,000).*
25 (iii) *For that portion of taxable income that is over one million*
26 *dollars (\$1,000,000), the tax rate is 2.5 percent of the excess over*
27 *one million dollars (\$1,000,000).*
28 (2) In the case of an ~~“S corporation”~~ “S” corporation that is
29 also a financial corporation, the rate of tax specified in paragraph
30 (1) shall be increased by the excess of the rate imposed under
31 Section 23183 over the rate imposed under Section 23151.

1 (c) An ~~“S corporation”~~ *“S” corporation* shall be subject to the
2 minimum franchise tax imposed under Section 23153.

3 (d) (1) For purposes of subdivision (b), an ~~“S corporation”~~
4 *“S” corporation* shall be allowed a deduction under Section 24416
5 or 24416.1 (relating to net operating loss deductions), but only
6 with respect to losses incurred during periods in which the
7 corporation is an ~~“S corporation”~~ *“S” corporation* for purposes
8 of this part.

9 (2) Section 1371(b) of the Internal Revenue Code, relating to
10 denial of carryovers between ~~“C years”~~ *“C” years* and ~~“S years,”~~
11 *“S” years*, shall apply for purposes of the tax imposed under
12 subdivision (b), except as provided in paragraph (1).

13 (3) The provisions of this subdivision do not affect the amount
14 of any item of income or loss computed in accordance with the
15 provisions of Section 1366 of the Internal Revenue Code, relating
16 to pass-thru of items to shareholders.

17 (4) For purposes of subdivision (b) of Section 17276, relating
18 to limitations on loss carryovers, losses passed through to
19 shareholders of an ~~“S corporation,”~~ *“S” corporation*, to the extent
20 otherwise allowable without application of that subdivision, shall
21 be fully included in the net operating loss of that shareholder and
22 then that subdivision shall be applied to the entire net operating
23 loss.

24 (e) For purposes of computing the taxes specified in
25 subdivision (b), an ~~“S corporation”~~ *“S” corporation* shall be
26 allowed a deduction from income for built-in gains and passive
27 investment income for which a tax has been imposed under this
28 part in accordance with the provisions of Section 1374 of the
29 Internal Revenue Code, relating to tax imposed on certain built-in
30 gains, or Section 1375 of the Internal Revenue Code, relating to
31 tax imposed on passive investment income.

32 (f) For purposes of computing taxes imposed under this part, as
33 provided in subdivision (b):

34 (1) An ~~“S corporation”~~ *“S” corporation* shall compute its
35 deductions for amortization and depreciation in accordance with
36 the provisions of Part 10 (commencing with Section 17001) of
37 Division 2.

38 (2) Section 465 of the Internal Revenue Code, relating to
39 limitation of deductions to the amount at risk, shall be applied in
40 the same manner as in the case of an individual.

(3) (A) Section 469 of the Internal Revenue Code, relating to limitations on passive activity losses and credits, shall be applied in the same manner as in the case of an individual. For purposes of the tax imposed under Section 23151 or 23501, as modified by this section, material participation shall be determined in accordance with Section 469(h) of the Internal Revenue Code, relating to certain closely held ~~“C—corporations”~~ “C” corporations and personal service corporations.

(B) For purposes of this paragraph, the “adjusted gross income” of the ~~“S—corporation”~~ “S” corporation shall be equal to its “net income,” as determined under Section 24341 with the modifications required by this subdivision, except that no deduction shall be allowed for contributions allowed by Section 24357.

(4) The exclusion provided under Section 18152.5 may not be allowed to an ~~“S—corporation.”~~ “S” corporation.

(5) The deduction for bad debts under paragraph (2) of subdivision (a) of Section 24348 may not be allowed to an ~~“S—corporation.”~~ “S” corporation.

(g) The provisions of Section 1363(d) of the Internal Revenue Code, relating to recapture of LIFO benefits, shall be modified for purposes of this part to refer to Section 19101 in lieu of Section 6601 of the Internal Revenue Code.

~~Taxation Code, to read:~~

~~23820. —A corporation may be allowed to elect to be treated as an “S corporation” under this part only if the corporation has less than twenty million dollars (\$20,000,000) in total gross receipts for the taxable year.~~

SEC. 2. This act provides for a tax levy within the meaning of Article IV of the Constitution and shall go into immediate effect.